HOMEOWNERS' GUIDE TO MORTGAGE RENEWAL

This booklet has been produced to give you some guidance when the time comes to renew the mortgage on your home. If you have further questions or need additional information, contact your lender, or the CMHC Local Office closest to you. Above all, plan well ahead so that the mortgage renewal arrangements are to your best advantage.

Disponible en français sous le titre de:
Le renouvellement du prêt hypothécaire
—Guide du propriétaire

Some questions you may have about mortgage renewal

Why mortgage renewal?

Mortgage renewal is a fact of life for homeowners today. It's because mortgage contracts usually expire in less time than it will take to pay off the loan in regular monthly instalments. It may be five years; it may be less. This is called the term of the mortgage.

Some homeowners confuse the term with the amortization period which is the time it will take to pay off the loan. The majority of new mortgages have a 25-year amortization period.

When the term expires, the unpaid principal is due for repayment. Usually, borrowers and lenders agree to extend the same contract for a further term at whatever the current level of interest may be. Often, it can be done by telephone or letter without visiting the lender's office. This is called a rollover.

On the other hand, you and your lender may choose to negotiate a new contract. If you do, the rate of interest, the length of the new term and the length of the amortization period are open to discussion and change. If you cannot agree on the terms of a new mortgage contract, you can pay the balance owing by borrowing from another lender.

How will I know when my mortgage must be renewed?

Prior to renewal date, your lender will send a notice advising you of the date your present term expires. In most cases, the renewal notice will include the offer of a new contract specifying a new term at a new interest rate. This notice arrives shortly before the date of renewal. To determine the mortgage renewal date in advance of hearing from your lender, refer to your copy of the contract. It specifies the date when your last payment is due and payable. Or contact your lender.

Does the lender have to renew?

While legally there is no obligation to renew mortgages, lenders are normally prepared to offer a renewal at prevailing rates.

With NHA-insured loans, lenders are required to renew mortgages when the borrower has demonstrated a satisfactory payment record.

Will the interest rate for the new term be the same?

Not necessarily. It is negotiated between you and the lender. The new interest rate will be based on market conditions at time of renewal.

Will the term be the same length of time?

Not necessarily. This is also open for discussion.

Do I have to keep my mortgage with the same lender?

No. Once the term has expired, your situation is similar to trying to arrange a new mortgage.

If you decide to change lenders then your new lender will likely require a new mortgage contract to be drawn up. This is to ensure that the security the mortgage provides for the loan meets their organization's legal requirements.

This involves the discharge of the existing mortgage and the registration of a new one which is usually arranged through a lawyer.

The new lender may accept the existing mortgage contract, amending it only to reflect the changes in the interest rate and other conditions. This is referred to as a mortgage assignment (transfer). Since it is arranged by the lender's lawyers, it is less costly to you.

More and more lenders offer reduced legal, appraisal and administrative fees, accept mortgage assignments, etc.

To find out whether the cost will outweigh any possible savings, the legal and administrative fees for the discharge (as well as the registration for transfer) should be discussed with your lender and lawyer before you make your decision.

You may wish to consult a mortgage broker as they can often obtain favourable financing through contacts with a wide range of lenders. Borrowers should be aware that if financing is obtained through a mortgage broker and the lender providing the mortgage does not have an office in your community, it will not be as convenient and will certainly take more time than dealing through a local office.

How much money will I owe at the end of my current term?

Lenders will provide a statement of your account, upon request, which will give the outstanding principal. It is important to note that the principal amount remaining on your mortgage is not the original mortgage amount less the accumulated monthly payments. In most repayment schemes, only a portion of your monthly mortgage payment reduces the principal; the rest pays off the interest.

For example, on a $40,000 equal payment mortgage with an interest rate of 11 per cent amortized over 25 years, after five years $2,000 in principal has been repaid, even though $23,000 in monthly payments have been made. Therefore, after five years the principal outstanding on this $40,000 loan would be $38,000.

At renewal, will my mortgage still be amortized over 25 years?

Not usually. The amortization period is usually reduced by the years paid in the previous term(s). For instance, if your original mortgage had a 25-year amortization period and a five-year term, your new payments would most likely be based on the principal balance at the end of the term, and on a 20-year amortization period.

Mortgage options

When you decide on the details of your mortgage renewal you have a number of choices. A selection of these are described on the following pages.

Remember, it is up to you to make sure you get the best value for your money. Take the time to talk it over with your present lender and other lenders in your area. Compare all the advantages and disadvantages very carefully.

Your final choice will depend on your circumstances, such as future increases in income, how much money you regularly save or whether you may be transferred to a job in another location. Also consider whether house prices are increasing, decreasing or remaining steady; whether interest rates are stable, going up, or on the way down.

To reduce future interest costs choose an open mortgage with prepayment privileges

An open mortgage allows the borrower to make partial payments during the term of the contract to reduce the outstanding principal loan amount. However, there is usually a penalty equivalent to three months' interest. You should check the amount of this penalty against the possible future savings on interest costs to decide if it is to your advantage. (For example, CMHC insured mortgages allow for a prepayment of ten per cent of the principal each year and payment in full after the third year, all with a three-month interest penalty.)

You should also keep in mind that you will probably pay a higher interest rate for an "open" mortgage.

For a lower interest rate, choose a closed mortgage which is not open to prepayment

If you feel you will not be able to make a prepayment during the term of the mortgage, it may be worthwhile choosing a closed mortgage because, although it does not offer the opportunity for prepayment, the lender may provide it at a lower interest rate. Remember they are in turn "borrowing" money from a depositor for the same term as the mortgage. If the interest rates drop, they cannot ask the depositor to accept a lower rate. The lender, therefore, will not alter your interest rate if rates drop.

To save on overall interest costs choose a shorter amortization period

The longer the amortization period, the smaller your monthly payments will be. However, the total amount of interest you pay increases substantially over a longer amortization period, especially if the interest rate is high.

Here is the difference in total costs for a $50,000 loan at 13 per cent over two different amortization periods:

Amortization Period	Monthly Payment	Interest Costs	Repaid Loan	TOTAL COSTS
25 years	$551.21	$115,363.00	$50,000	$165,363.00
15 years	$621.52	$ 61,873.60	$50,000	$111,873.60
DIFFERENCE:	$ 70.31	$ 53,489.40		

As a safeguard against sudden increases in interest rates, choose a longer term

Usually the longer the term, the higher the interest rate. But with a fixed interest rate over the length of a term of, for example, three to five years, you will have the security of knowing that you will not be facing an increase in the near future. In addition, you can reduce the disadvantage of a drop in interest rates during a longer term by selecting a mortgage contract which is open to prepayment.

or, if you think the interest rate will drop in the near future, choose a term of 1 year or less

If interest rates are high at the time of your mortgage renewal, you could switch to another lender who offers a lower rate. However, this usually entails legal and other fees which may outweigh the savings you could make by switching to a lender offering a lower rate. It may be wiser to stay with your present lender, but take a term of 1 year or less. Then you have the flexibility of arranging a longer term when interest rates are lower.

If you think interest rates are going to drop in the next few months, Variable Rate Mortgage may be your best option.

A Variable Rate Mortgage (VRM) is a method of arranging mortgage financing whereby the interest rate may go up or down with the market rate. The interest rate of a VRM is established by your lender according to an agreed formula and is usually set monthly. However, even though the rate may change from month to month, your monthly payments are likely to be adjusted only at the end of the year.

The advantage of a VRM is that any time the interest rate drops, you immediately benefit from the lower rate. Then, if you see that the rate is starting to increase you can convert immediately to a fixed rate mortgage. In addition, if the rate decreases, but your payments are kept at the same level, your outstanding balance will decrease faster.

The major disadvantage of a VRM is that if the interest rate goes up—and stays up—your mortgage balance increases. Consequently, your monthly payments will eventually increase accordingly and you may face financial hardship.

There may also be other disadvantages, depending on the type of VRM and terms and conditions available from one lender or another. For example, since a new mortgage document may be required to obtain a VRM, this may entail legal and other fees. Then, although you may repay some types of VRM mortgages in full at any time (and without penalty) you will probably have to pay additional legal fees and refinancing charges to obtain a new mortgage.

Another problem you may face is an increased minimum equity requirement. In other words, you may not be eligible for a VRM if you haven't already put enough money into buying the house.

Other options:
Partial yearly prepayment

Many borrowers take advantage of the option of prepaying part of the principal on each anniversary date during the term period. In other words, you might pay off part of the principal on the first, second, third and fourth year of a five-year term. Then, when it comes time to renew your mortgage in the fifth year, even though interest rates may be higher you may have reduced your principal by enough that you do not face high monthly payments.

Reduction of principal at renewal time

For immediate and long-term savings you should reduce your principal loan amount by making a lump sum payment at renewal time. The reason is simple: the less money you owe, the less interest you will have to pay in the future. Even if interest rates have just increased, if you start a new term with a lower principal loan amount, you will probably find your monthly payments are not significantly increased.

Glossary of Mortgage Terms

Amortization period:
The number of years it would take to pay off the mortgage debt.

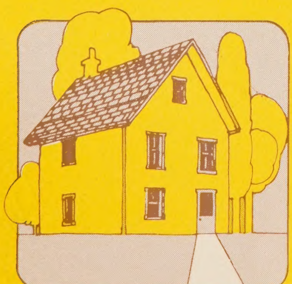
Buydown:
The payment of a lump sum to a lender to reduce the effective interest rate and therefore the level of monthly payments over a given period.

Closed mortgage:
No prepayments allowed on the principal amount of the mortgage during a given period of time.

Default:
Failure to abide by the terms of a mortgage loan agreement. Usually the failure to make mortgage payments at the time set forth in the mortgage contract.

Equity:
The interest of the owner in a property over and above all claims to the property. It is usually the difference between the amount of the mortgage principal and the total cost of the property at the initial stage.

Foreclosure:
A legally enforced transfer of real property ordered by a court to safisfy unpaid debts.



Insured mortgage:
A mortgage loan for which the lender is insured against default through a premium paid by the borrower. (This should not be confused with a life-insured mortgage.)

Mortgage:
A lien or claim against real property given by the buyer to the lender as security for money borrowed.

Prepayment privileges:
The prepayment of the principal amount in full or in part at a date earlier than that specified in the mortgage document.

Mortgage renewal:
The agreement between lender and borrower extending the mortgage when the term has expired.

Open mortgage:
A mortgage which allows a prepayment on the principal at a specified time before the end of the term, with or without a penalty charged to the borrower.

Paydown:
The payment of a lump sum to the lender to reduce the mortgage principal.

Principal:
The amount of money owing on the mortgage debt.

P.I.:
The combined principal and interest due monthly on a mortgage.

P.I.T.:
Principal, interest and property taxes.

P.I.T.H.:
Principal, interest, property tax and heating.

Term:
The contracted period of time during which the borrower must make a stipulated series of payments to a lender before the outstanding mortgage principal becomes due and payable.

Uninsured mortgage:
A mortgage in which the lender is not insured against borrower default.

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